



Helen Galt, FSA, MAAA
Company Actuary
Corporate Actuarial Department

Prudential Insurance Company of America
213 Washington Street, Newark, NJ 07102-2992
Tel (973) 802-4321 Fax (973) 802-5533
Helen.Galt@prudential.com

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The Honorable Karen Suter
Commissioner
New Jersey Department of Banking and Insurance
20 West State Street
Trenton NJ 08625

**RE: Treatment of Policyholders Discovered After the Effective Date to
Require Adjustments in the Distribution of Consideration**

Dear Commissioner Suter:

Prudential is providing this letter to confirm how Prudential proposes to handle eligible inforce policies that may have been affected by race based underwriting for the purposes of demutualization. We are specifically addressing how adjustments will be made should additional affected policyholders be discovered after the effective date and distribution of consideration. The procedures outlined in this letter address only affected inforce policyholders, some of which may have their demutualization distribution impacted by corrective procedures. This letter does not address inactive affected policyholders and the efforts Prudential has made to find affected policyholders in its inactive policy records. Further, since this letter pre-dates any potential agreement with the NJ Department of Banking and Insurance and/or a potential litigation settlement as to the appropriate means to remediate affected policyholders, it is offered as an assurance that, at a minimum, the action outlined will be taken. While Prudential believes the procedures outlined below are fair and appropriate, the Company understands and agrees that they are subject to the agreement and approval of the NJ Department of Banking and Insurance which may require additional or alternative procedures and remediation. Nothing in this letter is meant to waive or limit the Department's authority to impose different or additional requirements with respect to policyholders affected by the past practices of race based underwriting.

Background

Prudential conducted an extensive review of its records and files to determine how many inforce policies or contracts may still be affected by race based underwriting. For individual life business, Prudential stopped this practice in December, 1950 and took corrective action in the 1970's to remove these ratings. Our review has discovered 89 inforce policies requiring corrective action of the approximately 1.8 million policies in force which were written during the period when the Company engaged in these practices.

From the perspective of demutualization, the following facts are most relevant:

- For individual *Ordinary life insurance*, the Company has found 47 inforce policies with substandard ratings based on race out of approximately 625,000 policies issued prior to 1951. These policies were charged a substandard extra premium, and had not been identified in prior corrective actions that the Company had implemented to reverse these premiums.¹ Aside from the substandard extra premiums, these policies would have been issued with the same face amount and same cash values as other, unrated business. Additionally, the Company never paid separate dividends based on substandard ratings. The Company intends to correct the affected policies by returning all the extra premiums, with interest consistent with prior corrective action taken. The policy cash values and death benefits would not be impacted in any way by this relief, so the demutualization distribution is not affected.
- For *Intermediate life insurance*, the situation is virtually the same as for Ordinary. Race was recognized, during the period 1928 to 1950, by charging an extra premium, but the policy's face amount, cash values, and dividends were identical to those for unrated business. The Company has found 22 policies with race based ratings that had not been corrected through prior Company actions out of approximately 421,000 inforce policies.² The Company intends to correct these affected policies by returning all the extra premiums, with interest consistent with prior corrective action taken. Policy cash values and death benefits are not impacted in any way by this relief.
- For *Weekly premium life insurance*, the Company has found 20 policies with race based ratings that had not been corrected through prior Company actions out of approximately 740,000 inforce policies. Race was recognized for this branch of business as follows:

For *Adult Weekly policies* issued between 1935 and 1950, the policy was "rated up" in age. For a given amount of weekly premium, the policy's face amount and cash values were determined as if the insured were 1 to 7 years older than his or her actual age. Seventeen such inforce policies have been identified requiring correction. The Company intends to adjust the face amount (and corresponding cash values) for the Adult Weekly policies, so that the effect of the age rate-up is reversed which is consistent with prior corrective action. Because dividends on this business are always credited in the form of paid up additions, and are expressed as a cumulative addition to the face amount of insurance, this process will also appropriately adjust all dividends that would have been credited on these contracts. Because of the face amount and cash value adjustments, demutualization consideration for these 17 policies would potentially increase, as discussed more fully below.

For *Infantile Weekly Premium* policies issued between 1935 and 1950, a 15-20% extra premium was added. Three such inforce policies have been identified requiring

¹ Note that Prudential waived all substandard premiums on pre 1951 business in 1984, so no policies are currently being charged an extra premium based on race.

² For Intermediate business, all premiums, for all policies, were waived in 1981.

correction.³ The Company intends to correct these affected policies by returning all the extra premiums with interest consistent with prior corrective action taken. The cash values and death benefits for these three policies would not be impacted by this relief.

Implications for Demutualization

Eligibility

The Company will allocate demutualization consideration only with respect to policies that are inforce, or deemed to be inforce, as of the date the Board adopted the Plan of Reorganization which was December 15, 2000. Differences in premiums, face amounts, or other benefits do not affect eligibility for consideration.

Distribution of value

The Company plans to allocate a fixed component of consideration to each eligible policyholder (regardless of the number of eligible policies owned) and variable components of consideration with respect to each policy that has made, or will make, positive contributions to the Company's surplus.

For *Ordinary life insurance*, this process involves calculating year-by-year contributions to surplus for "model cells" of the company's business, where a model cell is a representative plan of insurance/issue age/issue year combination. The factors that go into these calculations include premiums, investment income, expenses, mortality charges, taxes, etc. The results of these model cell calculations are then extrapolated to all inforce policies by developing factors that are applied to the face amount and/or cash surrender value of each policy.

As noted above, the Company's practice for Ordinary life business has been to reflect substandard ratings (regardless of the reason for the rating) as a "non participating" extra premium, rather than by adjusting face amounts of insurance or cash surrender values. Any gains or losses associated with substandard ratings were broadly socialized across all policies for the purpose of calculating dividends on ordinary life policies—i.e., the dividends for a plan of insurance/issue age/issue year combination were the same, regardless of whether the individual was rated. Consistent with this financial management practice, demutualization consideration will also be calculated so that the same amount of consideration is allocated regardless of rating class. Therefore, the Company has concluded that any process to refund extra premiums based on race based ratings underwriting is independent of the calculations that are being done for demutualization and will not affect the allocation of demutualization consideration.

For *Intermediate life insurance*, the process of calculating contributions to surplus, and allocating variable shares, works essentially the same way as for Ordinary life insurance. No differentiation is made based on substandard rating class; any refunds of extra premiums will not affect the allocation of demutualization consideration.

³ Prudential did not use race based ratings for Weekly Premium policies during the period 1916-1934. As with Intermediate business, all premiums were waived in 1981.

For *Weekly Premium life insurance*, a similar procedure is used to calculate contributions to surplus for model cells; then factors are developed to extrapolate these results to all inforce policies. Raced based underwriting was implemented for Weekly Premium policies by rating up the insured's age for Adult policies or charging an extra premium for Infantile policies. For the Infantile policies where corrective action involves returning all excess premiums with interest, demutualization consideration will not be affected since as with the Ordinary and Intermediate policies this relief does not affect the face amount or cash value of the policy.

For the 17 Adult Weekly policies for which a remedy will be provided, the correction process will involve adjusting face amounts of insurance (and corresponding cash surrender values), which will affect the amount of demutualization consideration an eligible policyholder will receive. We will correct these policies before distribution of final consideration occurs, so that they will receive an appropriately adjusted share of the distribution. We believe that, while unlikely, it is possible that some affected policies could be identified after final consideration is distributed to policyholders. In that case, the Plan of Reorganization does provide for correction of errors in Section 14.10(a). Should additional affected policyholders be found after the distribution of final consideration where the remediation of the substandard rating affects the amount of demutualization consideration to which the policyholder was entitled, Prudential will recalculate the share allocation or cash allocation for these individuals and correct any deficiency.

Summary

The Company expects to make any necessary changes to policy records (such as updating face amounts of insurance or cash surrender values) before the distribution of final consideration to eligible policyholders. We can also rely on the error correction provisions of the Plan to handle any cases that are identified after the effective date and make any appropriate corrections.

Prudential is committed to taking whatever action is necessary to correct the vestiges of race based underwriting. The Company is equally committed to assuring that all eligible policyholders receive an allocation of consideration that appropriately takes into account the effects of such adjustments on the amount of demutualization consideration they will receive.

Very truly yours,

Company Actuary